CENTRAL BANKS

Unanimity to expand the balance sheet

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- The ECB is unanimous on the balance sheet expansion target of EUR1trn
- The ECB is making preparatory work for further measures, if they are needed
- The ECB will closely monitor the appropriateness of its monetary policy stance, hinting at further willingness to act

As expected, at today's monetary policy meeting the ECB left the key policy rate unchanged at 0.05% and took no additional steps on non-standard measures. However, the statement includes two important messages in terms of signalling. First, the introductory statement includes a reference on the balance sheet expansion, which "is expected to move towards the dimensions it had at the beginning of 2012". Thus, this fact confirms that the central bank has a clear target for the expansion and, more importantly, the Governing Council's (GC) unanimity on this. Later, at the Q&A session, Mr Draghi also clarified that when the GC referred to getting back to 2012 levels it meant that the balance sheet is expected to return to the level in March 2012 (after the second 3Y LTRO was held), which implies an increase in the balance sheet of around EUR1trn. Second, in order to reinforce its commitment and readiness to do more, the central bank said that it has asked the staff and relevant committees to prepare further measures to be implemented, if needed.

In this way, the dovish tone was reinforced and the easing bias was strengthened, as the ECB stated that it will closely monitor the appropriateness of its monetary policy stance, hinting at a willingness to act further. Moreover, Mr Draghi once more reasserted the GC's unanimity on the pledge to use further monetary policy tools within its mandate. On the inflation outlook, the GC will continue to monitor closely the risks for price developments (this time including an explicit reference to the repercussions of developments in energy prices), while risks to the economic outlook continue to be on the downside.

At the press conference, part of the attention was focused on the ways in which the ECB is ready to implement further measures. Mr Draghi highlighted that the GC expects that measures already taken will have a sizeable impact but if they do not, it is ready to act: "and so our balance sheet will continue to expand under all universe, either under the measures that we have already taken and/or those that we may have to take if needed." Moreover, he clarified that two contingencies would prompt the ECB to take further action: i) if the current measures are not enough (which shows the increasing doubts on the effectiveness of the tools already in place), and ii) if the medium-term inflation outlook worsens. As for any further measures, Mr Draghi said that there were no specific discussions on corporate bond purchases, and he reminded that the bank has a variety of instruments available. In response to a question on whether it has taken into account lessons from other central bank actions (QEs), Mr Draghi said that the GC has extensively discussed the experience of other central banks, and he stressed that these are very important in assessing transmission channels whereby additional measures were to be effective.

Regarding the minutes, these will start to be published after the January meeting. Mr Draghi specified that there are three key aspects to the discussions; i) the need to maintain the independence of the GC members; ii) the need to preserve the candour of the discussion and, iii) finally, and most important, the need to provide more information to markets to enable them to interpret the monetary policy decisions better.

The ECB´s commitment to increase its balance sheet significantly is in fact, more credible. Given the difficulty of achieving this target with measures approved so far (December TLTRO is key), a full-scale QE (i.e. purchase of government bonds) is likely to be needed to fill the gap.

PLEASE NOTE: **TRACKING CHANGES IN FOLLOWING STATEMENTS**

in black, wording common to both the current and previous statements, in red and crossed, previous wording that was replaced by new wording, in blue and underlined (YES, TRACK CHANGES ARE THERE ON PURPOSE)

Mario Draghi, President of the ECB,
~~Naples, 2 October~~Frankfurt am Main, 6 November 2014

Ladies and gentlemen, the Vice-President and I are very pleased to welcome you to our press conference. ~~I would like to thank Governor Visco for his kind hospitality and express our special gratitude to his staff for the excellent organisation of today's meeting of the Governing Council. We will now report on the outcome of our meeting~~We will now report on the outcome of today's meeting of the Governing Council, which was also attended by the Commission Vice-President, Mr Dombrovskis.

Based on our regular economic and monetary analyses, and in line with our forward guidance, we decided to keep ~~the~~ the **key ECB interest rates** unchanged. Following up on the decisions of ~~4 September~~2 October 2014, we ~~also decided on the key operational details of both the asset-backed securities purchase~~ last month started purchasing covered bonds under our new programme ~~and the new covered bond purchase programme.~~

~~This~~. We will ~~allow us to~~ also soon start ~~purchasing covered bonds and~~ to purchase asset-backed securities ~~(ABSs) in the fourth quarter of 2014, starting with covered bonds in the second half of October~~. The programmes will last for at least two years. Together with the series of targeted longer-term refinancing operations to be conducted until June 2016, these asset purchases will have a sizeable impact on our balance sheet, which is expected to move towards the dimensions it had at the beginning of 2012.

~~The new measures will support specific market segments that play a key role in the financing of the economy.~~Our measures will enhance the functioning of the monetary policy transmission mechanism, support financing conditions in the euro area, facilitate credit provision to the real economy and generate positive spillovers to other markets. They will thereby further ~~enhance the functioning of the monetary policy transmission mechanism, facilitate credit provision to the broad economy and generate positive spillovers to other markets. Taking into account the overall subdued outlook for inflation, the weakening in the euro area's growth momentum over the recent past and the continued subdued monetary and credit dynamics, our asset purchases should~~ ease the monetary policy stance more broadly~~. They should also strengthen~~ , support our forward guidance on the key ECB interest rates and reinforce the fact that there are significant and increasing differences in the monetary policy cycle between major advanced economies.

~~Together with the monetary accommodation already in place, the determined implementation of the new measures~~ With the measures that have been put in place, monetary policy has responded to the outlook for low inflation, a weakening growth momentum and continued subdued monetary and credit dynamics. Our accommodative monetary policy stance will underpin the firm anchoring of medium to long-term inflation expectations, in line with our aim of ~~maintaining~~achieving inflation rates below, but close to, 2%. As ~~all our measures~~ they work their way through to the economy ~~they~~ , our monetary policy measures will together contribute to a return of inflation rates to levels closer to our aim.

However, looking ahead, and taking into account new information and analysis, the Governing Council will closely monitor and continuously assess the appropriateness of its monetary policy stance. Should it become necessary to further address risks of too prolonged a period of low inflation, the Governing Council is unanimous in its commitment to using additional unconventional instruments within its mandate. The Governing Council has tasked ECB staff and the relevant Eurosystem committees with ensuring the timely preparation of further measures to be implemented, if needed.

~~A separate press release will provide further information on the modalities of our new purchase programmes for ABSs and covered bonds. It will be released at 3.30 p.m.~~

Let me now explain our assessment in greater detail, starting with ~~the~~ the **economic analysis**. ~~Following four quarters of moderate expansion, euro area real GDP remained unchanged between the first and second quarter of this year. Survey~~

~~data available up to September confirm the weakening in the euro area's growth momentum, while remaining consistent with a modest economic expansion in the second half of the year. Looking ahead to 2015, the outlook for a moderate recovery in the euro area remains in place, but the main factors and assumptions shaping this assessment need to be monitored closely. Domestic~~Euro area real GDP increased by 0.1%, quarter on quarter, in the second quarter of this year, revised up as compared with the earlier estimate. Since the summer months, incoming data and survey evidence have overall indicated a weakening in the euro area's growth momentum. This information has now been incorporated into the most recent forecasts by private and public institutions, which indicate a downward revision of real GDP growth over the projection horizon up to 2016, with the outlook for a modest economic recovery remaining in place. This picture is broadly in line with the Governing Council's current assessment. On the one hand, domestic demand should be supported by our monetary policy measures, the ongoing improvements in financial conditions, the progress made in fiscal consolidation and structural reforms, and lower energy prices supporting real disposable income. Furthermore, demand for exports should benefit from the global recovery. ~~At~~On the ~~same time~~other hand, the recovery is likely to continue to be dampened by high unemployment, sizeable unutilised capacity, ~~continued negative bank loan growth to the private sector,~~ and the necessary balance sheet adjustments in the public and private sectors.

The risks surrounding the economic outlook for the euro area ~~remain~~ continue to be on the downside. In particular, the ~~recent~~ weakening in the euro area's growth momentum, alongside heightened geopolitical risks, could dampen confidence and, in particular, private investment. In addition, insufficient progress in structural reforms in euro area countries constitutes a key downward risk to the economic outlook.

According to Eurostat's flash estimate, euro area annual HICP inflation was 0.~~3~~4% in ~~September~~October 2014, after 0.~~4~~3% in ~~August.~~September. Compared with the previous month, this mainly reflects a ~~stronger decline in energy prices and~~ somewhat ~~lower price~~ less negative contribution from energy prices and slightly stronger annual increases in ~~most other components of the HICP.~~food prices. A fall in industrial goods prices was partly compensated for by an increase in services price inflation. On the basis of current information and prevailing futures prices for energy, annual HICP inflation is expected to remain at around current low levels over the coming months, before increasing gradually during 2015 and 2016. This is also the picture portrayed by the most recent forecasts, which now incorporate the recent sharp fall in oil prices.

The Governing Council will continue to closely monitor the risks to the outlook for price developments over the medium term. In this context, we will focus in particular on the possible repercussions of dampened growth dynamics, geopolitical developments, exchange rate and energy price developments, and the pass-through of our monetary policy measures.

Turning to ~~the~~ the **monetary analysis**, data for ~~August~~September 2014 continue to point to subdued underlying growth in broad money (M3), with the annual growth rate increasing moderately, however, to 2.~~0~~5% in ~~August~~September, after 2.1~~.8~~% in ~~July.~~August. Annual growth in M3 continues to be supported by its most liquid components, with the narrow monetary aggregate M1 growing at an annual rate of ~~5.8~~6.2% in ~~August~~September.

The annual rate of change of loans to non-financial corporations (adjusted for loan sales and securitisation) remained negative at -1.8% in September, after -2.0% in August~~, after~~ and -2.2% in ~~the previous month.~~July. On average over recent months, net redemptions have moderated from the historically high levels recorded a year ago. Lending to non-financial corporations continues to reflect the lagged relationship with the business cycle, credit risk, credit supply factors and the ongoing adjustment of financial and non-financial sector balance sheets. The annual growth rate of loans to households (adjusted for loan sales and securitisation) was 0.6% in September, after 0.5% in August~~, broadly unchanged since the beginning of 2013~~. In line with some stabilisation in credit flows, the October bank lending survey for the euro area reported a net easing of credit standards on loans to enterprises and households. At the same time, it has to be kept in mind that the level of credit standards is still tight from a historical perspective. Following the completion of the ECB's comprehensive assessment, a further strengthening of banks' balance sheets can be expected to contribute to reducing credit supply constraints and facilitating more lending.

~~Against the background of weak credit growth, the ECB is now close to finalising the comprehensive assessment of banks' balance sheets, which is of key importance to overcome credit supply constraints.~~

To sum up, ~~a~~ a **cross-~~check~~** **check** of the outcome of the economic analysis with the signals coming from the monetary analysis confirms the recent decisions taken by the Governing Council to provide further monetary policy accommodation and to support lending to the real economy.

Monetary policy is focused on maintaining price stability over the medium term and its accommodative stance contributes to supporting economic activity. However, in order to strengthen investment activity, boost job creation and ~~potential~~raise productivity growth, other policy areas need to contribute decisively. In particular, the legislation and implementation ~~of structural reforms clearly need to gain momentum in several countries. This applies to~~ of **product and labour ~~markets~~** **market reforms** as well as ~~to~~ actions to improve the business environment for firms need to gain momentum in several countries. The effective implementation of structural reforms will raise expectations of higher incomes and encourage firms to increase investment today and bring forward the economic recovery. As ~~regards~~ regards **fiscal policies**, ~~euro area~~ countries with remaining fiscal imbalances should not unravel the progress already made and should proceed in line with the rules of the Stability and Growth Pact. ~~This should be reflected in~~Throughout the procedural steps under the agreed framework, the ~~draft budgetary plans for 2015 that governments will now deliver, in which they will address the relevant country-specific recommendations. The~~ Pact should remain the anchor for confidence in sustainable public finances~~, and the~~. The existing flexibility within the rules should allow governments to address the budgetary costs of major structural reforms, to support demand and to achieve a more growth-friendly composition of fiscal policies. A full and consistent implementation of the euro area's existing fiscal and macroeconomic surveillance framework is key to bringing down high public debt ratios, to raising potential growth and to increasing the ~~euro area's~~ resilience of the euro area economy to shocks.

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